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# SUPREME COURT OF THE UNITED STATES

**OCTOBER TERM, 1941**

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## No. 283

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BUTLER BROTHERS,

*Appellant,*

*vs.*

CHARLES J. McCOLGAN, AS FRANCHISE TAX COMMISSIONER OF THE STATE OF CALIFORNIA.

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APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA.

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## STATEMENT OPPOSING JURISDICTION AND MOTION TO DISMISS OR AFFIRM.

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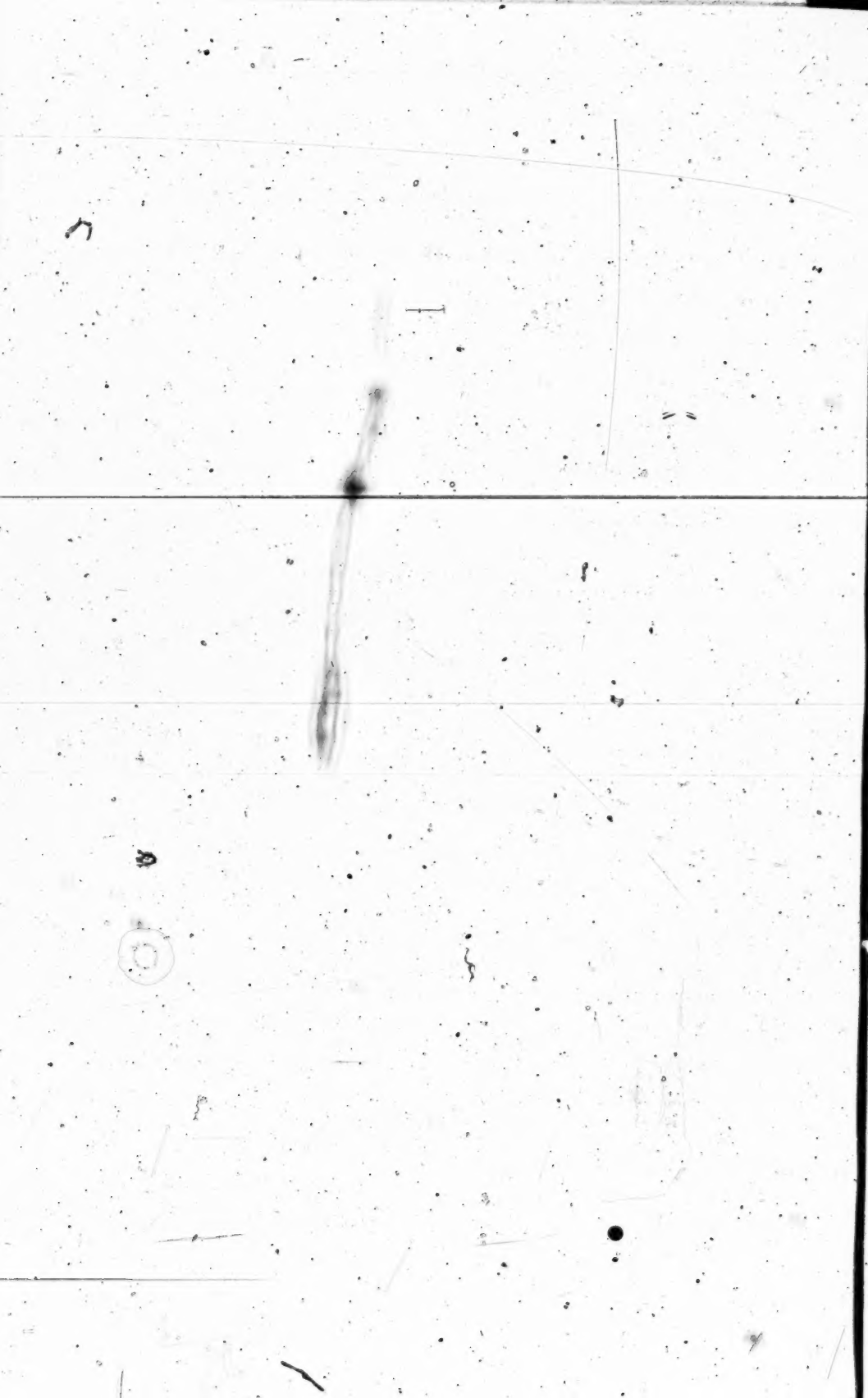

# SUPREME COURT OF THE UNITED STATES

## OCTOBER TERM, 1941

## No. 283

BUTLER BROTHERS, A CORPORATION,

*Appellant,*

*vs.*

CHARLES J. McCOLGAN, AS FRANCHISE TAX COMMISSIONER OF THE STATE OF CALIFORNIA,

*Appellee.*

## MOTION TO DISMISS OR AFFIRM AND STATEMENT OPPOSING JURISDICTION.

*May it please the Court:*

Appellee in the above entitled cause moves the court to dismiss this appeal or to affirm the judgment below for the following reason:

1. There is no substantial Federal question presented as a basis of jurisdiction in this Court, because the questions presented have been so thoroughly foreclosed by previous decisions of this Court as to leave no debatable ground for attacking the decision of the Supreme Court of California, and therefore the questions presented are unsubstantial.

Wherefore, appellee moves the Court to dismiss the appeal in this cause for lack of a substantial Federal question.

or, in the alternative, to affirm the judgment of the Supreme Court of California from which this appeal was taken, for the reason that the questions presented are foreclosed by prior decisions of this Court.

## ARGUMENT IN SUPPORT OF MOTION.

### Statement of the Case, Including the Facts.

This cause involves the validity of a tax collected by appellee from appellant pursuant to provisions of the Bank and Corporation Franchise Tax Act of California, which imposes on corporations doing business in California a franchise tax measured by net income. (*Cf. Pacific Co.* v. *Johnson*, 285 U. S. 480, affirming 212 Cal. 148, 298 Pac. 489, and *Matson Navigation Co.* v. *State Board of Equalization*, 297 U. S. 441, affirming 3 Cal. (2d) 1, 43 Pac. (2d) 805). The appellant claimed that its operations in California in the year 1935 resulted in a net loss, whereas the appellee applied a formula to appellant's entire net income and allocated to California a portion of that income. The appellant paid the tax so computed and sued to recover it. The California Supreme Court affirmed the judgment of the superior court, thus denying appellant the recovery sought and upholding the allocation made by appellee.

The facts are stipulated and show that appellant is an Illinois corporation which operates seven wholesale stores, one of which is in California. The goods sold in all of appellant's wholesale houses are purchased by it through its central purchasing division. Appellant also has a central advertising division, a central accounting division and central executives. These central divisions are located in Illinois. By reason of the volume of appellant's sales it is able to buy in great volume, thus purchasing at lower prices than if it operated only one store. According to books of account kept at the California house, appellant's California

operations were conducted at a net loss, although appellant's business throughout the United States, of which the California business was a part, was conducted at a profit of $1,149,677.

Appellant's California books are kept by a recognized separate accounting method, which is more fully described in the stipulation of facts. The appellee refused to agree that the California business was actually operated at a loss and determined the net income attributable to California by an allocation based on a three-factor formula of property, payroll and sales. By this formula 8.1372% of appellant's entire net income was allocated to California, which percentage was computed by averaging the percentages which the California tangible property, payroll and sales bore to appellant's total tangible property, payroll and sales. Appellant stipulated that this formula is proper if any formula is.

**Cases Believed to Have Foreclosed the Questions Presented, Thus Rendering Them Unsubstantial.**

The Supreme Court of California held that appellant's business was a unitary business, i. e., one which operates in several States as one unit so that the division of the business into several geographical units separated by State lines would be artificial, not real. That court based this conclusion on the fact that the California store contributed to the sales volume which enabled appellant to purchase at more favorable prices than it otherwise could have done. Reliance was also placed on the California store's contributing to the maintenance of appellant's central advertising division, central accounting division, and central executives. From this conclusion the California court reached the further conclusion that the California store necessarily contributed something to appellant's business throughout the

United States, and was a component factor in producing appellant's net income of $1,149,677.

The conclusion of the California court that appellant's business is unitary in character is fully supported by the decision of this Court in *Great Atlantic & Pacific Tea Co.* v. *Grosjean*, 301 U. S. 412, where the Louisiana chain store tax was upheld notwithstanding that it was imposed at a graduated rate which varied with the total number of stores in the chain, including those in other States. This Court pointed out the advantages attendant on volume selling possessed by such chains, and held that those advantages need not be disregarded by the States in taxing such chains even though the volume selling was partly the result of sales by stores in other States. These advantages, which are obtained by operating several stores as a unit, also result in the earning of net income. Thus, while the decision did not involve the allocation of income, it was based on the same reason as the reason for treating a business as unitary.

The conclusion that appellant's business is unitary in character is also supported by *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113, and *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U. S. 271. Just as a corporation which manufactures goods for sale must sell them to derive income, so a corporation which buys goods for sale must sell them to derive income.

As appellant's business is unitary in character, a formula such as that herein may properly be used by California in allocating to California the portion of appellant's net income attributable to business done in California.

*Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113;

*Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U. S. 271;

*Norfolk & Western Ry. Co.* v. *Maxwell*, 297 U. S. 682;
*North American Cement Corp.* v. *Graves*, 299 U. S. 517;
*Cf. Hans Rees' Sons* v. *North Carolina*, 283 U. S. 123.

These decisions likewise hold that the use of a formula not inherently arbitrary (and the formula herein is agreed to be proper if any formula can be) will be upheld as against constitutional objections where the formula is not shown to produce an unreasonable result.

The only evidence offered by appellant to prove that the formula in this case has produced an unreasonable result is its separate accounting, taken from the books of its California store. By this separate accounting appellant seeks to establish that its California operations resulted in a net loss instead of net income. Separate accounting cannot accurately reflect the source of income in the case of a unitary business and this Court has recognized that fact. In three cases already decided by this Court, allocation by separate accounting was offered to overthrow the results of formula allocation, and in each case this Court held that separate accounting was insufficient evidence. These cases:

*Underwood Typewriter Co.* v. *Chamberlain, supra*;
*Bass, Ratcliffe & Gretton, Ltd.* v. *State Tax Commission, supra*;
*North America Cement Corporation* v. *Graves, supra.*

The separate accounting in the *Underwood Typewriter* case, as disclosed by the record in that case, was strikingly similar to that offered here. The obvious fallacy of the allocation by separate accounting in that case well illustrates the impossibility of obtaining a correct allocation in the case of a unitary business by the use of separate accounting. In the *Bass Ale* case by the use of separate accounting the taxpayer offered proof that its American operations had resulted in a net loss. According to the

record in that case 93% of the taxpayer's business was conducted in New York, so if the evidence had been deemed creditable the inference would have been permissible that the New York business also resulted in a loss. Yet the New York formula, which allocated a portion of the taxpayer's entire net income to that State, was upheld. In the *North American Cement* case, the taxpayer complained of the New York formula and offered an elaborate separate accounting allocation, prepared and certified by a leading accounting firm, to prove that its actual net income from New York was less than that allocated to New York by the formula. The separate accounting in that case, as in the instant case, attributed a loss to the taxing State in some of the years involved. The evidence was held insufficient to overthrow the results of the formula allocation.

Furthermore, the separate accounting allocation offered by appellant allocates to California $75,000 of expenses which, it is stipulated, would have been incurred even if the California store had not operated. (Paragraph 4, Stipulation of Facts). While this is agreed to be in accordance with recognized accounting principles, it is impossible to reconcile with an attack on the formula theory of allocation. Manifestly it tends to produce a distorted result. Then, too, appellant, while attacking the use by appellee of a formula in allocating net income, allocates a portion of the expenses of maintaining its central divisions by a method which can only be some other formula. This Court has held that the formula method of allocation cannot be accepted in part and attacked in part.

*Norfolk & Western Ry Co.* v. *Maxwell*, 297 U. S. 682.

The decision in *Hans Rees Co.* v. *North Carolina*, 283 U. S. 123, does not cast doubt on the decision of the California Supreme Court. There the taxpayer offered an elaborate

analysis of its method of operation and of the factors creating its profits, which tended to show that a much smaller percentage of its net profits was allocable to North Carolina, where the major factory was located, than the 86% which the formula allocated to that State. The evidence tended to show that manufacturing was only slightly responsible for its profits, whereas the formula had the effect of attributing nearly the entire profits to one state of manufacture. This Court held that such evidence, treated as true, overthrew that particular formula, because it was proved that that formula attributed to North Carolina "a percentage of income out of all appropriate proportion to the business transacted * * * in that State." It is worthy of note that the formula herein is based on the percentage of business done in California, and not merely on property owned. Thus the income allocated to California was in exact ratio to the proportion of the business transacted in California. Appellant has not offered an analysis of the causes of its net income, but on the contrary has merely offered a different bookkeeping system which produces a result different from the result reached by appellee. Nothing has been offered to explain why appellant's method of operation should produce a loss in California while it was producing a large income from its total operations. The source of that large income has not been shown, whereas it was shown in the *Hans Rees* case, and the possibility certainly exists, unrefuted by the record, that separate accounting, used in turn to allocate the income of each of appellant's stores, would show a loss for each of them. Neither have business conditions been shown to exist which would cause a variation in California from the normal and hence cause a loss to be suffered in California while identical operations elsewhere produced a large income. With these

gaps in appellant's evidence, it cannot be said that appellant has proved oppression by clear and cogent evidence, which is appellant's burden. (*Norfolk & Western Ry. Co.* v. *Maxwell, supra*).

Possibly appellee may have misinterpreted *Bass, Ratcliff & Gretton Ltd.* v. *State Tax Commission, supra,* and *North American Cement Corporation* v. *Graves, supra,* by failing to interpret those cases as holding that a State franchise tax measured by net income may constitutionally be measured by a portion of the corporation's entire net income even though the operations in the taxing State for the previous year were conducted at a loss. There is an implication in the *Bass Ale* case that such is the view of this Court. If that be the case, those decisions support the decision below on that ground as well as on the ground previously discussed, for the tax herein involved, like the New York tax, is a franchise tax on the exercise of corporate franchises, measured by the preceding year's statutory net income, or an allocated portion of it.

**The Asserted Disregard by the California Court of a Stipulation Regarding the Effect to be Given Inferences and Presumptions is Not a Ground for Reversal.**

The sixth specification of error by appellant charges the California Supreme Court with reversible error for indulging in inferences and presumptions assertedly contrary to paragraph 12 of the stipulation of facts. Any oversight on the part of the California court regarding that stipulation would be mere error, which is not a denial of due process and does not give this Court jurisdiction.

*Corrigan* v. *Buckley*, 271 U. S. 323;
*Worcester County Trust Co.* v. *Riley*, 302 U. S. 292.

The construction which appellant seeks to place on paragraph 12 is unwarranted, and is also a two-edged sword. The stipulation reads insofar as important as follows:

> "It is agreed • • • that the Court • • • shall be bound by no inference or presumption in respect of any matter of fact not herein set forth • • •."

The purpose of this stipulation was to overcome the presumption of official regularity, and not to shift the burden of proof from plaintiff to defendant or to remove the burden of proof from both parties. Apparently appellant is preparing to argue that the case should have been decided without drawing any inference from the agreed facts or without insisting that one party bear the burden of proof. The stipulation is admittedly, on its face, susceptible to that interpretation, although that was not its purpose. If that is the interpretation then appellant has stipulated itself out of court, for the parties did not stipulate that appellant suffered a loss from its California business; they merely stipulated facts from which appellant asks this Court to draw such an inference.

Respectfully submitted,

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